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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR	DOCKET NO. E-00000A-01-0630 AECC'S COMMENTS ON AISA ISSUES

Pursuant to the Commission's August 30, 2001 Procedural Order, Phelps Dodge Corporation, ASARCO, Incorporated and Arizonans for Electric Choice and Competition[1] (collectively referred to herein as "AECC") hereby file the following comments concerning the Arizona Independent Scheduling Administrator ("AISA"):

1. State and discuss the purpose of the AISA.

As stated in its Bylaws, the purpose of the AISA is to facilitate open, non-discriminatory transmission access to Arizona's transmission system until a regional transmission organization ("RTO" e.g., Desert STAR) becomes operational.

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[1] Arizonans for Electric Choice and Competition is a coalition of energy consumers in favor of competition and includes Amigos, Arizona Association of Industries, Arizona Retailers Association, Arizona Rock Products Association, Arizona School Boards Association, ASARCO, Boeing, Chemical Lime Company, Hickman's Egg Ranch, Homebuilders Association of Central Arizona, Honeywell, Intel Corporation, Leisure World Community Association, Lockheed Martin, Motorola, ON SemiConductor and Phelps Dodge.

This statement of purpose follows directly from the Commission's Electric Competition Rules, which state that:

> "The Commission supports the development of an Independent System Operator (ISO) or, absent an Independent System Operator, an Arizona Independent Scheduling Administrator (AISA). The Commission believes that such organizations are necessary in order to provide nondiscriminatory retail access and to facilitate a robust and efficient electricity market." R14-2-1609(C).

Simply put, the AISA exists to provide the means for parties to gain access to the transmission system in order to conduct retail transactions pursuant to the Commission's Electric Competition Rules. Absent an AISA, there are simply no rules or protocols in place that address the unique transmission access needs associated with implementing a state retail access program. The AISA was developed specifically to fill this void and to provide parties a platform for conducting retail electric business in Arizona.

2. State and discuss the necessity of the AISA and whether it contributes (or not) to the development of retail competition.

The AISA is necessary so long as two conditions continue to exist: (1) Arizona customers have the right to retail access, and (2) an RTO is not yet operational.

Successful retail competition requires robust wholesale markets, a rational unbundled pricing structure, and fair and efficient access to the wires. The AISA is intended to address only the latter of these requirements: fair and efficient access to the wires. To better discuss the AISA's importance to retail competition, it is necessary to briefly discuss the other requirements for successful retail competition: robust wholesale markets and a rational unbundled pricing structure.

The recent volatility problems experienced in western wholesale power markets are well known and have been a major impediment to the development of retail competition in Arizona. Generally, the design of wholesale power markets is outside the purview of the Commission's regulation; however, state regulators can influence the long-term performance of these markets through appropriate incentives (or lack of disincentives) for construction of new generation facilities, efficient consideration of transmission siting requests, and by allowing utilities providing standard offer service appropriate flexibility in procuring resources. Recent indications are that wholesale power markets are settling down, and the tremendous interest in construction of new generating facilities in the region bodes well for Arizona consumers in the future.

The second requirement for successful retail competition, a rational unbundled pricing structure, refers to the manner in which the various components of retail service – e.g., distribution, transmission, generation, and "transition charges" – are priced. In Arizona, the unbundled pricing structure, including the determination of transition charges to resolve the "stranded cost" issue, was established as an integral part of the settlement agreements with APS and TEP, to which Arizonans for

Electric Choice and Competition is a party.[2]

In the case of the APS settlement agreement, the transition charge (or CTC) decreases each year according to a set schedule. The determination of the CTC was based on a forecast of wholesale prices: to the extent that wholesale prices significantly exceed the forecast, the structure of the unbundled rates will be an impediment to retail competition. AECC hastens to add that such a possibility was a known risk at the time of the settlement agreement: the agreement is a package deal with other features that made this risk acceptable to customers, in particular, a five-year schedule of rate decreases for standard offer service and a schedule for phasing out APS' considerable regulatory asset charges. In light of the price stability it has provided to customers, the APS settlement agreement has served Arizona well.

What has all this to do with the AISA?

Customer interest in direct access will return as wholesale prices decline; and as wholesale prices decline, the APS unbundled pricing structure will become more rational – that is, the CTC will better align with previous price forecasts and become less of an impediment to retail competition. Thus, two of the requirements needed for retail competition will improve simultaneously. It would be a terrible irony, then, if the Commission were now to dispose of the mechanism that it had wisely mandated in the first place to ensure that the third

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[2] <u>See</u> Decision No. 61973 approving the APS Settlement Agreement; Decision No. 62103 approving the TEP Settlement Agreement.

requirement for retail competition was in place: namely, the fair and efficient access to the wires provided by the AISA. Such an action would ensure that customers would remain deprived of at least one of the elements needed for successful retail competition.

Why is the AISA, in particular, needed to ensure fair and efficient access to the wires for retail service?

As stated above, until an RTO is operational, there are simply no rules or protocols in place that address the unique transmission access needs associated with implementing a state retail access program. Some parties may contend that mere reliance on existing FERC-approved open-access transmission tariffs is sufficient. Such a view is simply wrong. Standard FERC-approved transmission tariffs were developed with wholesale transactions in mind: they are woefully inadequate for dealing with the special challenges of retail competitive service, as will be shown below. Obviously, FERC concurs with our view, at least implicitly, as FERC has approved the AISA Protocols and Tariff, which were developed to be used instead of the utilities' wholesale transmission tariffs for retail transactions in Arizona.

Competitive retail service provides many special challenges that come under the general rubric of "transmission access," including, among other things, the need to adapt transmission scheduling requirements to be compatible with retail competitive service, the tailoring of ancillary services to support retail transactions, the determination of equitable energy balancing requirements, and the establishment of efficient and equitable rules to ensure the provision of "must-run" generation in load pockets such as Phoenix and Tucson. The AISA Protocols address each of these special challenges - and provides a mechanism for resolving disputes associated with them.

But no special challenge in the establishment of competitive retail service is as important as the fundamental question of transmission allocation among retail customers. When the Commission's Electric Competition Rules were being developed, transmission allocation was a topic of considerable controversy. In a transmission system that is heavily used, certain paths become "congested" - that is, parties wish to schedule more transactions over certain paths connected to important generating facilities and market hubs than the transmission facilities can reliably accommodate.

Initially, Arizona utilities contended that customers who purchased from competitive suppliers would have access only to those transmission paths that were not needed by the utility to serve its own standard offer customers. In other words, the most valuable transmission paths would be unavailable to competitive customers. AECC and other parties pointed out that such an approach would doom retail competition to failure. Moreover, today's standard offer customer could be tomorrow's competitive customer - and that customer should not be forced to forfeit its ability to be served using the most important transmission paths

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simply because it switched power providers.

Ultimately, the Commission required that competitive customers receive a pro-rata allocation of transmission rights on the paths used to provide retail service. The details implementing this requirement were painstakingly negotiated under the auspices of the AISA and incorporated into the Protocols Manual. Later, to resolve a "critical mass" problem for the initial competitive suppliers, the AISA adopted an interim transmission allocation (with the cooperation of the utilities and the approval of FERC) that assured access to important market hubs for certain threshold amounts of competitive retail service.

In short, retail competition cannot occur without a means for fairly and efficiently allocating transmission. In Arizona, this function is performed by the AISA. This function will transfer to an RTO (using a different allocation mechanism, but similar principles) when an RTO becomes operational. Under the most optimistic projections, an RTO will not be operational in Arizona until late 2003.

3. State and discuss the functions of the AISA.

The Electric Competition Rules denote a number of specific functions for the AISA, including calculation of Available Transfer Capability (ATC) and implementation of a transmission planning process. <u>See</u> R14-2-1609. However, the AISA Board recognizes that these functions are being performed today by other parties, and has elected not to incur the staffing and other costs that would be required to undertake these functions at the present time. Instead, the AISA has limited its functions to those that are most central to its role in facilitating non-discriminatory transmission access for retail customers: implementation of the Protocols Manual and provision of dispute resolution. (Both of these functions are also required in the Rules.) AECC agrees that limiting the AISA's functions to those particular activities is appropriate at this time.

4. State and discuss the costs of the AISA

The AISA is staffed by two employees, the Acting Executive Director and an Office Manager.

At its current level of functionality, the AISA should cost around $400,000 per year, or a little more than one penny per MWH. By way of comparison, residential electric service in Arizona costs around $100.00 per MWH. By way of further comparison, in keeping with its Settlement Agreement, APS has reduced residential rates three times in the last three years in increments of about $1.50 per MWH (with two more decreases to come).

Desert STAR, with significantly greater responsibilities than the AISA, is projected to cost around $57 million in start-up capital costs and $25 million per year to operate, which AECC estimates to be around 25 to 30 cents per MWH for operations plus amortization of capital expense.

5. State and discuss the need to continue the AISA.

As discussed in response to Question 2 above, the AISA is necessary so long as two conditions continue to exist: (1)

Arizona customers have the right to retail access, and (2) an RTO is not yet operational.

An argument has been made that, in completing the Protocols Manual, the work of the AISA is finished. AECC disagrees. While the development of the Protocols Manual was a major accomplishment of the AISA, its approval by FERC was gained with the understanding that the Protocols Manual was the product of an independent organization, and there was every presumption that this independent organization would remain responsible for the continued administration of the protocols. Moreover, while AECC does not foresee any major changes to the protocols, it is inevitable that adjustments will be needed. For instance, the interim allocation of retail transmission will expire in December 2001. Under current market conditions, it is important that this interim allocation be extended. The AISA is the only viable vehicle for working out such adjustments.

If the AISA is terminated, there will simply not be any independent transmission oversight in Arizona until an RTO is operational at the end of 2003 or later.

6. State and discuss the timing and procedures for terminating the AISA.

The AISA should be terminated when an RTO becomes operational and assumes the responsibilities for ensuring non-discriminatory access to the transmission system for retail transactions. The AISA should monitor RTO development activity and plan to transfer its responsibilities to the appropriate RTO

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when such an operations date occurs.

7. State and discuss the AISA relationship to and with Desert STAR.

See response to Question No. 8 below.

8. State and discuss the AISA relationship to and with any regional multi-state ISO or RTO that will serve Arizona.

At the present time, the only RTO under consideration for serving Arizona is Desert STAR, so Questions 7 and 8 will be answered together.

The most fundamental relationship between the AISA and Desert STAR is that, pursuant to its own Bylaws, the AISA will cease operations when Desert STAR becomes operational. In the meantime, the only entity with approval from FERC to perform independent oversight over the transmission system in Arizona is the AISA. For its part, Desert STAR intends to file its tariff in late September 2001, but does not plan to become operational until late 2003. The AISA will be needed until Desert STAR (or an alternative RTO) is operational.

The AISA is not a replacement or alternative to an RTO, but is an interim organization designed to address the more limited, albeit important, issues associated with retail access. In general, the parties involved with the AISA are also involved with Desert STAR. For instance, three of the AISA Board members also serve as ex-officio members of the Desert STAR Board. Consequently, there is a high degree of awareness among the AISA stakeholders concerning Desert STAR activities.

9. Address the legal ramifications to the APS and TEP settlement agreements if those utilities are no longer required to support the AISA.

AECC views this question as positing a contradiction-in-terms: By the terms of their respective settlement agreements, APS and TEP are required to support the AISA:

> "APS shall actively support the Arizona Independent Scheduling Administrator ("AISA") and the formation of the Desert Star Independent System Operator." [APS Settlement Agreement, 7.6]

> "TEP shall fully support the development of the Arizona Independent Scheduling Administrator ("AISA") and Desert STAR." [TEP Settlement Agreement, 9.1]

Since, according to its own Bylaws, the AISA will terminate when a regional transmission organization is operational in Arizona, APS and TEP will be "no longer required to support the AISA" when the AISA is supplanted by an RTO.

A.A.C. R14-2-1609 also requires APS and TEP, as Affected Utilities, to support the AISA.[3] If, over AECC's objection, the Commission were to eliminate that Rule, APS and TEP would still remain bound by their settlement agreements to continue to support the AISA. Note that both settlement agreements contain provisions stating that any future Commission order, rule, or regulation shall be construed and administered, insofar as possible, in a manner so as to not conflict with the specific

[3] Furthermore, the rule sets forth in detail the required characteristics of the AISA including nondiscriminatory operating protocols, dispute resolution, standardized scheduling and planning. Each aspect of the AISA provides a critical component to ensuring a fair and effective competitive market.

provisions of the Settlement Agreement, as approved by the Commission. Moreover, to the extent that the settlement agreement is inconsistent with a provision of a future Commission order, rule, or regulation, the parties are obligated to seek a waiver from that provision. [TEP Settlement Agreement, 14.3; APS Settlement Agreement, 7.1]

Both the APS and TEP settlement agreements are providing significant benefits to Arizona consumers, not the least of which is price stability for a considerable period of time when much of the west is experiencing significant rate increases. Those agreements were negotiated as package deals with multiple components. AECC believes it would be unfair and unwise to attempt to "cherrypick" either of those agreements, causing any of the parties to the agreements to lose the benefit of their bargain.

10. State and discuss any other relevant/pertinent items/information that you believe the Commission should consider regarding the AISA.

It has been suggested that it would be reasonable to terminate the AISA and rely upon the transmission owners to administer the transmission protocols until an RTO is in place. As discussed in the attached letter from Stan Barnes, President AECC, to Commissioner Marc Spitzer dated July 24, 2001, there are several problems with that approach.

First, one of the major reasons for RTO formation is that such self-administration is viewed as inherently flawed due to utility conflicts of interest.

Second, FERC has approved the protocols in question as AISA protocols, and has explicitly rejected earlier attempts by APS to include similar protocols (prior to AISA Board approval) in its own transmission tariff. The clear message from FERC is that it matters that the transmission protocols are developed and overseen by an independent organization.

Third, while the protocols are complete, it is inevitable that adjustments will have to be made on a going-forward basis. For example, the recent demise of the California Power Exchange made it necessary to adjust the definition of "market price" used in the AISA Energy Imbalance protocol.

Fourth, the temporary retail transmission allocation mechanism is due to expire on December 15, 2001 (the original start date of Desert STAR) and will have to be revisited. The AISA is the only viable vehicle for dealing with such adjustments. Absent the auspices of the AISA, these needed adjustments will simply not occur. For opponents of the AISA and retail access generally, this may be the result they seek to obtain.

Based on the foregoing reasons, AECC requests that the Commission maintain the AISA.

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DATED this 5th day of September, 2001.

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By

C. Webb Crockett
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Original and 10 copies filed this 5th day of September, 2001 with Docket Control.

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RE-000001-94-0165

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Arizonans for Electric Choice and Competition

Coalition Members:

Amigos
Arizona Association of Industries (AAI)
Arizona Retailers Association
Arizona Rock Products Association (ARPA)
Arizona School Boards Association
ASARCO
Boeing
Chemical Lime Company
Hickman's Egg Ranch
Homebuilders Association of Central Arizona
Honeywell
Intel Corporation
Leisure World Community Association
Lockheed Martin
Motorola
ON SemiConductor
Phelps Dodge

July 24, 2001

The Honorable Marc Spitzer
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Dear Commissioner Spitzer:

I would like the opportunity to respond to a number of points you made in your July 12 letter to your fellow Commissioners regarding the Arizona ISA (AISA). As you know, Arizonans for Electric Choice and Competition (AECC) played a major role in negotiating settlement agreements with APS and TEP that removed many of the barriers to retail electric competition in Arizona. One of the barriers we addressed was access to the transmission system. A key provision of our settlement agreements involves support for the AISA, which has the responsibility to ensure non-discriminatory access to the transmission system for retail customers prior to the implementation of an RTO.

You correctly point out that events in California have had a chilling effect on retail competition in Arizona, at least for now. Nevertheless, we are both seeing the responsiveness of market forces at work, as new generation is being planned and built to meet our energy needs. I agree with your assessment that a retail electric market will develop in Arizona that will result in more choice and lower rates for customers.

This brings me back to the importance of the AISA. Thanks to the Commission, Arizonans have the legal option to shop for electric power today. Indeed, customers in the Tucson area were shopping as recently as April. As wholesale prices settle down and option again. The AISA is necessary to ensure that when the economics support retail additional generation is built, many Arizona retail customers will wish to explore this competition, the non-discriminatory transmission access will be there for customers.

Your letter implies that Desert STAR is ready to take up this responsibility. Unfortunately, such is not the case. Desert STAR, by its own reckoning, will not be operational before the end of 2003 – two and one half years from now. Its timetable has already slipped several times. Most recently, it has delayed a promised filing at FERC while the region's transmission owners ponder alternative forms of RTO governance. In the meantime, FERC has issued new policy statements strongly favoring the formation of a single RTO for the western U.S. – a policy prescription that further increases the complexity of RTO formation. If the Arizona ISA is shut down as you recommend, retail transmission access will fall into a void for at least two and a half years. And given the track record of RTO formation in the Southwest, it will likely be longer than that.

Ironically, the hardest and most expensive part of the AISA's job – developing protocols and securing their approval from FERC – has already been completed. The going-forward costs of keeping the two-person organization in place are small. By way of comparison, the projected AISA operating costs of 3 cents per MWH is about *one-fiftieth* the size of the most recent APS rate reduction for residential customers – which as you know is just one of five annual reductions negotiated by AECC in the same settlement agreement that provides for support of the AISA.

Your letter suggests that it would be reasonable to shut down the AISA and rely upon the transmission owners to administer the transmission protocols until an RTO is in place. I must point out several problems with that approach. First, as you know, one of the major reasons for RTO formation in the first place is that such self-administration is viewed as inherently flawed due to utility conflicts of interest. Second, FERC has approved the protocols in question as AISA protocols, and has explicitly rejected earlier attempts by APS to include similar protocols (prior to AISA Board approval) in its own transmission tariff. The clear message from FERC is that *it matters* that the transmission protocols are developed and overseen by an *independent* organization.

Third, while the protocols are complete, it is inevitable that adjustments will have be made on a going-forward basis. For example, the recent demise of the California Power Exchange made it necessary to adjust the definition of "market price" used in the AISA Energy Imbalance protocol. Next on the horizon, the temporary retail transmission allocation mechanism is due to expire on December 15, 2001 (the original start date of Desert STAR) and will have to be revisited. The AISA is the only viable vehicle for dealing with such adjustments. Absent the auspices of the AISA, these kinds of needed updates will simply not occur. And for some opponents of the AISA and retail access generally, that is probably the whole idea.

Finally, AECC's own experience leaves us strongly opposed to the notion that we can simply rely on the utilities to oversee the fair administration of retail access protocols. Just this past April, all retail access activity in TEP's territory was wiped out after TEP, in violation of the settlement agreement it entered into with AECC, and in violation of its own tariff, unilaterally altered the method for calculating the shopping credit. Ironically, this action helped set the stage for the present justification to disband the AISA because "there is no retail competition" in Arizona. In an attempt to avoid litigation, AECC is working with TEP to resolve the shopping credit problem and we are hopeful that retail access can return to the TEP territory in the near future. However, we are very concerned that this latest proposal to shut down the AISA will create yet another obstacle to restoring the confidence of marketers and customers to return to direct access service in Arizona.

In summary, I urge you to reconsider your views toward the forward-going role of the AISA in light of this additional information. The AISA was created to implement Arizona policy. At the Commission's direction and with its support, the AISA was approved by FERC. It provides a much-needed backstop to ensure that Arizona's retail access policies can be carried out during the indefinite amount of time it is taking to form an RTO.

Thank you for your consideration.

Sincerely,

Stan Barnes
President

Cc: Honorable Jim Irvin
Cc: Honorable Bill Mundell